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No. 908

In the Supreme Court of the United States

OCTOBER TERM, 1959

THOMAS McCAFFREY, JR. and LILLIAN S. McCAFFREY,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the Tax Court (R. 4a-12a)[1] is reported at 31 T. C. 505. The opinion of the Court of Appeals (Pet. 26-38) is reported at 275 F. 2d 27.

JURISDICTION

The judgment of the Court of Appeals was entered on February 10, 1960. The petition for a writ of certiorari was filed on May 5, 1960. The jurisdiction

[1] Record references are to the printed pages of the record appendix to the petitioners' brief in the Court of Appeals.

of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Whether Section 112(f) of the Internal Revenue Code of 1939, providing for the non-recognition of gain in certain circumstances, is applicable to taxpayer's gain, resulting from the condemnation of his parking lot property, because the warehouse property he acquired with the proceeds therefrom was not "similar or related in service or use" to the condemned property.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(f) [as amended by Section 1 of the Act of October 31, 1951, c. 661, 65 Stat. 733]. *Involuntary Conversion.*—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

* * * * *

(3) *Conversion into money where disposition occurred after 1950.*—Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) *Nonrecognition of Gain.*—If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 112.)

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

SEC. 39.112(f)-1 *Involuntary conversion where disposition of the converted property occurred after December 31, 1950*— * * *

* * * * *

(c) *Conversion into money or into dissimilar property.* (1) If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, the gain, if any, shall be recognized, at the election of the taxpayer, only to the extent that the amount realized upon such conversion

exceeds the cost of other property purchased by the taxpayer which is similar or related in service or use to the property so converted, or the cost of stock of a corporation owning such other property which is purchased by the taxpayer in the acquisition of control of such corporation, * * *.

* * * * *

(9) There is no investment in property similar in character and devoted to a similar use if:

(i) The proceeds of unimproved real estate, taken upon condemnation proceedings, are invested in improved real estate.

* * * * *

STATEMENT

In 1947, the taxpayer[2] paid $15,000 for an interest in a tract of land located in Pittsburgh, Pennsylvania, which had been filled, graded and blacktopped and was used as a commercial parking lot. The tract was level with the street and rectangular in shape, measured 80 feet by 180 feet, and had an unused railroad siding. There was a small frame building on the property which was adaptable for use only in the operation of a parking lot. The property was served by the usual utilities—water, gas, electricity and telephone—and was leased and used as a parking lot throughout the entire period during which the taxpayer owned an interest in it. (Pet. 27-28.)

In 1952, the Commonwealth of Pennsylvania con-

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[2] The taxpayer's wife is a party to the proceeding only because a joint return was filed for the taxable year (1953).

demned the property and the taxpayer received $57,477 for his interest, of which $42,477 was gain to him. In August 1953, he invested the proceeds in a purchase of all of the stock of the Arsenal Corporation, whose sole asset was certain property located in New Castle, Pennsylvania, which had been purchased for $155,000 through negotiations carried on by the taxpayer. (Pet. 28-29.) This property consisted of a 9-1/3 acre tract, industrially zoned, which had been owned by the American Can Company. Located on it was a two-story, 694 by 80 feet, building of brick and wood construction with concrete and wood floors and equipped with elevators, sprinkler and heating systems. The building also had an engine room, garages and lumber shed. A part of the tract was surfaced with blacktop and cinders and was used for parking purposes by executives, employees and customers of a corporation conducting business on an adjacent property. Another part had cinder surfacing for use in parking incidental to unloading shipments by rail on two sidings which served the property. (Pet. 28-29.)

Prior to the purchase of this property by the Arsenal Corporation, the taxpayer arranged to lease it to the Federal Civil Defense Administration for warehouse purposes, on a year-to-year basis, after making certain repairs, alterations and improvements. Approximately $100,000 was spent in making the repairs and improvements required by the lease commitment. The rental paid by the Administration did not include any amount as a charge for use of the property for parking purposes. (Pet. 29.)

The income tax deficiency in issue is for the year 1953 and was based on the Commissioner's determination that the taxpayer is not entitled to the benefits of the non-recognition of gain provisions of Section 112(f) of the Internal Revenue Code of 1939 in relation to his gain from the condemnation of the parking lot property. (Pet. 29-30.) The Tax Court (Pet. 30) and the Court of Appeals (Pet. 30-38) upheld the Commissioner's determination on the ground that the requirements of Section 112(f) were not fulfilled because the New Castle property was not "similar or related in service or use" to the parking lot property. (Pet. 29-30.)

ARGUMENT

1. The decision below is correct. The taxpayer's gain on the condemnation of the parking lot property is taxable unless the exception to the recognition of gain contained in Section 112(f) of the Internal Revenue Code of 1939 (*supra*, p. 2) is applicable. Under that exception, the proceeds from an involuntary conversion must be used to purchase, or to acquire control through stock ownership of, other property "similar or related in service or use to the property so converted * * *." As the court below held (Pet. 30-38), the two properties involved here—parking lot property and warehouse property—are not similar or related "in service or use" *as property*. The taxpayer does not contend that they are. He argues, rather, that the required similarity of service or use does not apply to the property itself, and that it is sufficient that he had the "subjective" intent to "use"

the warehouse property (Pet. 15) for the production of rental income (Pet. 16-19). But, as the court below stated (Pet. 31-32), the statute "is not concerned with 'why' taxpayer invests the proceeds of the converted property, but only 'how' he does so * * *." In contrast to the taxpayer's contention, the courts have repeatedly applied a functional test, requiring a close identity of purpose and use as between the two properties involved. See *Lynchburg Nat. Bank & T. Co.* v. *Commissioner*, 208 F. 2d 757 (C.A. 4th); *Edmond Weil, Inc.* v. *Commissioner*, 150 F. 2d 950 (C.A. 2d); *Cotton Concentration Co. v. Commissioner*, 4 B.T.A. 121; *Flaxlinum Insulating Co.* v. *Commissioner*, 5 B.T.A. 676, 681; *Washington Market Co.* v. *Commissioner*, 25 B.T.A. 576, 583; *Haberland* v. *Commissioner*, 25 B.T.A. 1370; *Buckhardt* v. *Commissioner*, 32 B.T.A. 1272; *Caldbeck Corp.* v. *Commissioner*, 36 B.T.A. 452; *Kimbell-Diamond Milling Co.* v. *Commissioner*, 10 T.C. 7; *Massillon-Cleveland-Akron Sign Co.* v. *Commissioner*, 15 T.C. 79; *Collins* v. *Commissioner*, 29 T.C. 670; Cf. Rev. Rul. 58-245, 1958-1 Cum. Bull. 274, with Rev. Rul. 56-347, 1956-2 Cum. Bull. 517, 518.

2. There is no direct conflict of decisions. In one of the two cases cited by the taxpayer, no question was even presented on appeal as to the similarity of the converted and replacement properties. *Winter Realty & Const. Co.* v. *Commissioner*, 149 F. 2d 567 (C.A. 2d).[3] *Steuart Bros., Inc.* v. *Commissioner*, 261

[3] At one point (Pet. 16) the taxpayer also asserts that the decision below is in conflict with this Court's decisions

F. 2d 580 (C.A. 4th), does contain language suggesting that different standards might be used in classifying property under the statute because of the difference in status of the owner, *i.e.*, whether investor or user. But the same court had previously applied a functional test in *Lynchburg Nat. Bank & T. Co.* v. *Commissioner*, *supra*, and it apparently had no intention of eliminating that factor from consideration in the *Steuart Bros.* case. Thus, its decision in the latter case is rested in large part on its conclusion that the new property was "of the same general character" (p. 582) or "same general class" (p. 584) as the old. The net result seems to be a rather liberal application of the functional test. In any event, the case is factually distinguishable from the present case and, contrary to the taxpayer's assumption, does not stand for the proposition that the mere reinvestment of condemnation proceeds is, *per se*, sufficient to satisfy the service or use requirement of Section 112(f).

3. The question presented is not an important one requiring resolution by this Court. It is an esssentially factual question, and whatever importance the issue might have had has been greatly minimized by the enactment of legislation in 1958, which, as taxpayer concedes (Pet. 23), eliminates, for the future, any possible confusion in relation to the replacement

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in *Woolford Realty Co.* v. *Rose*, 286 U.S. 319, and *McWilliams* v. *Commissioner*, 331 U.S. 694. Those cases did not involve Section 112(f) or a predecessor statute, and the taxpayer does not attempt to explain the asserted conflict.

of rental real estate.[4] See Section 46 of the Technical Amendments Act of 1958, P. L. 85-866, 72 Stat. 1606; S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 71-72 (1958-3 Cum. Bull. 922, 992-993.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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[4] This statute, though it is more liberal than Section 112(f), would not avail a taxpayer in the situation involved in the present case; it does not apply where (as here) condemnation proceeds are used to acquire the stock of a corporation which owns property.

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